

REPORT OF THE EXECUTIVE OFFICER
State Allocation Board Meeting, February 27, 2008

MATERIAL INACCURACY PENALTIES

PURPOSE OF REPORT

1. To present the practices used to determine the recommended length of time for the loss of self-certification in association with a Material Inaccuracy.
2. To present the methods used to calculate the interest penalty associated with Material Inaccuracy for projects with funding advantages and for projects requiring rescission.

BACKGROUND

As a result of discussions involving Material Inaccuracy items presented at the January 30, 2008 State Allocation Board (SAB) meeting, Staff was requested to present, at a future SAB meeting, the background and methodologies used in recommending interest penalties and the loss of self-certification. The SAB indicated it wished to consider possible changes to the current Material Inaccuracy regulations and requested that the background and methodologies of this report be discussed at an Implementation Committee meeting. Staff anticipates presenting an item at the March 2008 Committee meeting.

A FINDING OF MATERIAL INACCURACY

Only the SAB can make a finding of Material Inaccuracy and impose interest penalties and the loss of self-certification. Senate Bill 2066, Chapter 590, Statutes of 2000 (O'Connell), which became effective on January 1, 2001, added Education Code (EC) Section 17070.51 that provides the Office of Public School Construction (OPSC) shall notify the SAB if any certifications of eligibility or funding application related information is found to have been falsely certified by school districts, architects or design professionals. Additionally, this EC Section provides the SAB with the authority to impose penalties if Material Inaccuracies have occurred. (See Attachment A for the full text of EC Section 17070.51.) Material Inaccuracy is further defined in School Facility Program (SFP) Regulation Section 1859.2 as any falsely certified application that allowed the district an advantage in the funding process. Under the law and regulations governing Material Inaccuracy, the term "falsely certified" is used. It is not necessary for the SAB to determine that the certification was knowingly false. The term in this context is the simple and common meaning of inaccurate or not true. This standard does not require a finding of any intent or specific knowledge on the part of a district.

Before interest penalties and loss of self-certification can be imposed on a district, the SAB must find that a Material Inaccuracy occurred for the district. Staff presents research, analysis, and recommendations to the SAB for Material Inaccuracy consideration. Material Inaccuracy board items involve a rigorous process of analysis and review of all project information by Staff. The analysis and review includes all district-submitted information and any information on file at the OPSC. Identified issues are then evaluated to the standards set forth in statute and regulation. Should a violation of statute or regulation exist, Staff will move forward with an item to the SAB. Based on the information provided in the item, Staff may make the following recommendations to the SAB, but not limited to:

- A finding that a Material Inaccuracy occurred
- Require the district to repay the additional funding received beyond the amount the district was entitled to for the project
- Require the district to repay the interest resulting from the funding advantage in order to make the bond funds whole
- Prohibit the district from self-certification for a period of up to 5 years

INTEREST PENALTIES ON PREMATURE FUND RELEASES

The most common form of Material Inaccuracy is a premature certification on the *Fund Release Authorization* form that the school district entered into binding contract(s) for at least 50 percent of the construction included in the plans applicable to the State-funded project. Before an interest penalty for a premature fund release can be assessed, the SAB must find that a district received a funding advantage as a result of a false certification on the *Fund Release Authorization* form. A funding advantage occurs when the district prematurely certifies, but the district did not meet this certification until

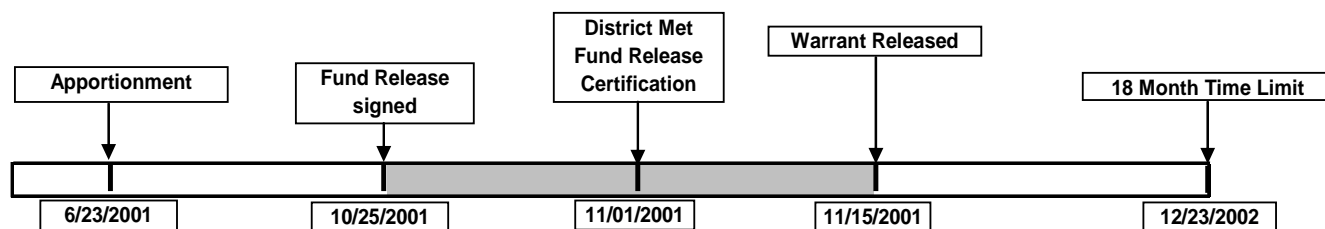
INTEREST PENALTIES ON PREMATURE FUND RELEASES (cont).

after the warrant was released. Since the funds were prematurely released to the district, the district received a funding advantage and the State lost interest on these funds during the period of time that the funds should have remained in the State bond fund accruing interest. (See Attachment A for statute and regulations regarding premature fund releases.) There are three possible scenarios for a premature fund release, two of which would involve a recommended interest penalty.

SCENARIO 1

PREMATURE FUND RELEASE (NO FUNDING ADVANTAGE, NO MATERIAL INACCURACY)

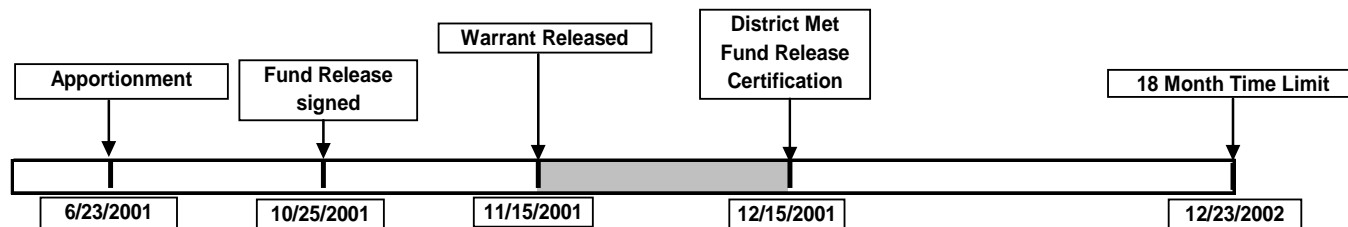
In this scenario, even though the district prematurely certified on 10/25/2001 (i.e., did not have at least 50 percent of the work in the plans and specifications under contract), there was no funding advantage obtained by the district. The district met the *Fund Release Authorization* certification through various contracts on 11/1/2001, before the warrant was released and therefore received no interest or funding advantage. The shaded area on the timeline below represents the period, after the fund release authorization was signed, in which the district could still have met the *Fund Release Authorization* certification and still not have obtained a funding advantage.



SCENARIO 2

PREMATURE FUND RELEASE (FUNDING ADVANTAGE, MATERIAL INACCURACY)

The example below represents a premature fund release with a funding advantage. The district certified on 10/25/2001 to have met the certification on the *Fund Release Authorization* form; however, the district did not comply with the fund release requirements until 12/15/2001. The funding advantage (shaded area) occurred from the date the warrant was released on 11/15/2001 to when the district met the *Fund Release Authorization* requirements on 12/15/2001. The number of days associated with the funding advantage (interest on funds that should not have been released) is 30 days.



INTEREST PENALTIES ON PREMATURE FUND RELEASES (cont).

SCENARIO 2 (cont.)

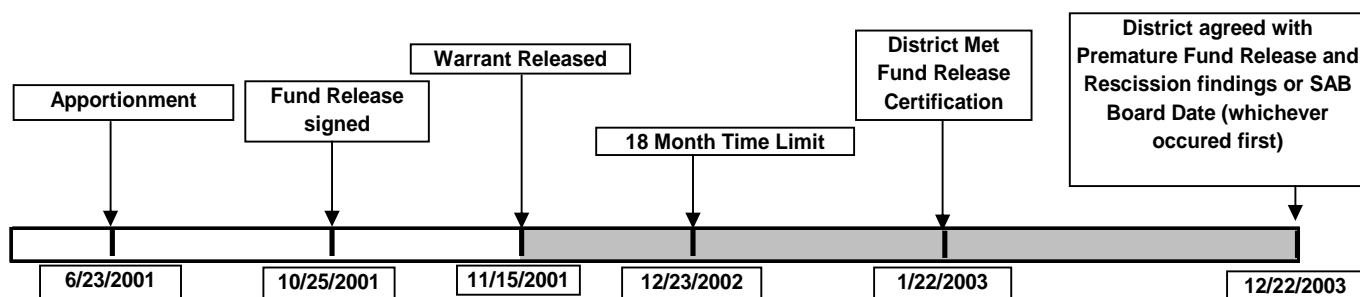
The following is an example of how interest penalties would be calculated on the project in Scenario 2. In this example, the amount of the warrant released was \$500,000, the Pooled Money Investment Board (PMIB) Rate the State was earning at the time the warrant was issued to the district was 3.526%, and the number of days of the funding advantage was 30 days. The formula for the calculation of interest penalty for the above scenario is as follows:

- *Warrant Amount times the Annual Interest Rate divided by 365 days times the Number of Days of the Funding Advantage, or*
- $\$500,000 \times (3.526\% / 365) \times 30 = \$1,449$ in recommended interest penalties.

SCENARIO 3

PREMATURE FUND RELEASE (FUNDING ADVANTAGE, MATERIAL INACCURACY COMBINED WITH VIOLATION OF LAW REQUIRING RESCISSION)

Scenario 3 presents an additional and more serious violation of the law than Scenarios 1 and 2 because it also includes a project rescission. The rescission is due to a violation of EC Section 17076.10(d). (See Page Two of Attachment A for the full text of EC Section 17076.10(d).) This section of law requires that once a district receives an apportionment for a project, the district has a maximum of 18 months to meet the criteria to have the funds released. When this time limit is not met, the EC requires that *the board shall rescind the apportionment and deny the district's application*. The law contains no provision for extension or exemption. In this example, the 18-month time limit expired on 12/23/2002. By the time the district had binding contract(s) for at least 50 percent of the construction included in the plans on 1/22/2003, it had already exceeded the 18-month time limit in law, the project was required by law to be rescinded, and the project approval was no longer valid. As a result, the district did not and does not qualify to receive a fund release. Since the funds were released to the district, the district received a funding advantage (shaded area), and the State lost interest on these funds during the period of time that the funds should have remained in the State bond fund earning interest. Therefore, the interest is calculated from the date the warrant was released to the date the district agreed with the finding, or the date the item is presented to the SAB, whichever occurs first.



For this scenario, the amount of the warrant released was \$500,000, the Pooled Money Investment Board (PMIB) rate the State was earning at the time the warrant was issued to the district was 3.526%, and the number of days of the funding advantage was 767 days. The formula for the calculation of interest penalty for the above scenario is as follows:

- *Warrant Amount times the Annual Interest Rate divided by 365 days times the Number of Days of the Funding Advantage or*
- $\$500,000 \times (3.526\% / 365) \times 767 = \$37,047$ in recommended interest penalties
- Additionally, the \$500,000 must be returned to the State

(Continued on Page Four)

LOSS OF SELF-CERTIFICATION RECOMMENDATIONS FOR PREMATURE FUND RELEASES

Before a loss of self-certification can be imposed, the SAB must find that a Material Inaccuracy had occurred. (See Attachment A for statute and regulations regarding loss of self-certification.) In making loss of self-certification recommendations to the SAB, Staff considers a number of factors relative to the project(s) being audited as well as previously closed projects of the district. Those factors include:

- Did the project(s) meet the *Fund Release Authorization* requirements before the 18-Month Time Limit on Fund Release?
- Does the district have prior rescission(s) associated with premature fund releases?
- What is the cumulative total, in days, of all non-compliance for all premature fund releases for the district? (Note: Non-compliance refers to the period from warrant release date to the date the district met the *Fund Release Authorization* requirements for past and current items.)
- Does the district have other audit findings related to current or past audits?
- Are there any other mitigating circumstances to consider?

Most of these factors are incorporated in a flowchart (See Attachment B) that assists Staff in formulating a loss of self-certification recommendation to the SAB.

PAST MATERIAL INACCURACIES

Since the inception of the School Facility Program in 1998, the SAB has found seven districts to be materially inaccurate, including two districts at the January 2008 SAB meeting. Staff's recommendations have generally been consistent with the guidelines set forth in Attachment B. In all cases, the districts received funding advantages as summarized in Attachment C. The seven districts are referenced as alpha characters in Attachment C, and the attachment also includes if interest penalties were levied as a result of the funding advantage, and the duration of the loss of self-certification.

RECOMMENDATIONS

1. Accept this report.
2. Request Staff to discuss this report and the Material Inaccuracy regulations at the March 2008 Implementation Committee meeting.
3. Request Staff to present its recommendations regarding possible changes to the current Material Inaccuracy regulations including the loss of self-certification and the calculation of interest penalties at a future SAB meeting.

BOARD ACTION

In considering this item, the State Allocation Board on February 27, 2008 approved the staff's recommendations with a modification to Recommendation No. 1, which was to "receive" rather than "accept" the report.

ATTACHMENT A

AUTHORITY

EDUCATION CODE SECTION 17070.51

17070.51. (a) If any certified eligibility or funding application related information is found to have been falsely certified by school districts, architects or design professionals, hereinafter referred to as a material inaccuracy, the Office of Public School Construction shall notify the board.

(b) The board shall impose the following penalties if an apportionment and fund release has been made based upon information in the project application or related materials that constitutes a material inaccuracy.

(1) Pursuant to a repayment schedule approved by the board of no more than five years, the school district shall repay to the board, for deposit into the 1998 State School Facilities Fund, an amount proportionate to the additional funding received as a result of the material inaccuracy including interest at the rate paid on moneys in the Pooled Money Investment Account or at the highest rate of interest for the most recent issue of state general obligation bonds as established pursuant to the Chapter 4 (commencing with Section 16720), of Part 3 of Division 4 of Title 2 of the Government Code, whichever is greater.

(2) The board shall prohibit the school district from self-certifying certain project information for any subsequent applications for project funding for a period of up to five years following the date of the finding of a material inaccuracy or until the district's repayment of the entire amount owed under paragraph (1). Although a school district that is subject to this paragraph may not self-certify, the school district shall not be prohibited from applying for state funding under this chapter. The board shall establish an alternative method for state or independent certification of compliance that shall be applicable in these cases. The process shall include, but shall not be limited to, procedures for payment by the school district of any increased costs associated with the alternative certification process.

(c) For school districts found to have provided material inaccuracies when a funding apportionment has occurred, but no fund release has been made, the board shall direct its staff to reduce the apportionment as necessary to reflect the actual nature of the project and to disregard the inaccurate information or material, and paragraph (2) of subdivision (b) shall apply.

(d) For those school districts found to have provided material inaccuracies when no funding apportionment or fund release has been made, the inaccurate information or materials shall not be considered, and paragraph (2) of subdivision (b) shall apply. The project may continue if the application, minus the inaccurate materials, is still complete.

AUTHORITY REGARDING PREMATURE FUND RELEASE AND RESCISSION

Fund Release Criteria

EC Section 17072.32 in part states that the essential element necessary to meet the criteria of a fund release is to have "...a binding contract for the completion of the approved project".

SFP Regulation Section 1859.90 states, "...the OPSC will release State funds that have been apportioned by the Board to the district after submittal, by the district, of the Form SAB 50-05."

Form SAB 50-05, incorporated by reference in SFP Regulation Section 1859.90, requires the district, as a condition of funding, to certify that it has entered into a binding contract(s) for at least 50 percent of the construction included in the plans applicable to the state funded project.

EC Section 17072.32(a) states, "For any project that has received an apportionment pursuant to Section 17072.30, funding shall be released in amounts equal to the amount of the local match upon certification by the school district that the school district has entered into a binding contract for completion of the approved project."

Material Inaccuracy

SFP Regulation Section 1859.2 (Definition of Material Inaccuracy), "Means any falsely certified eligibility or funding application related information submitted by the school districts, architects or other design professionals that allowed the school district an advantage in the funding process."

AUTHORITY REGARDING PREMATURE FUND RELEASE AND RESCISSION (cont.)

Material Inaccuracy (cont.)

To make a finding of Material Inaccuracy, EC Section 17070.51(a) states, "If any certified eligibility or funding application related information is found to have been falsely certified by school districts, architects or design professionals, hereinafter referred to as a Material Inaccuracy, the OPSC shall notify the Board."

Material Inaccuracy Penalties

EC Section 17070.51(b) states that, "The board shall impose the following penalties if an apportionment and fund release has been made based upon information in the project application or related materials that constitutes a Material Inaccuracy."

EC Section 17070.51(b)(1) states that, "Pursuant to a repayment schedule approved by the board of no more than five years, the school district shall repay to the board...an amount proportionate to the additional funding received as a result of the Material Inaccuracy including interest at the rate paid on moneys in the Pooled Money Investment Account..."

Repayment of Material Inaccuracy Interest Penalty

SFP Regulation Section 1859.104.1(c)(1) states the district "must repay the additional funding received beyond the amount the district was entitled to for the project with interest within five years from the date the Board made the finding of Material Inaccuracy. Interest shall be assessed as prescribed in Education Code Section 17070.51(b)(1)."

Rescission of Project Apportionment

EC Section 17076.10(d) states, "If a school district has received an apportionment, but has not met the criteria to have funds released pursuant to Section 17072.32 or 17074.15 within a period established by the board, but not to exceed 18 months, *the board shall rescind the apportionment* and deny the district's application."

SFP Regulation Section 1859.90 states, "...a district must submit the Form SAB 50-05, within 18 months of the Apportionment of the SFP grant for the project or the entire...apportionment shall be rescinded without further Board action, and the pupils housed in the project, if applicable, will be added back to the district's baseline eligibility. The district may re-file a new application for the project subject to district eligibility and priority funding at the time of resubmittal."

AUTHORITY REGARDING LOSS OF SELF-CERTIFICATION

EC Section 17070.51(b)(2) states that, "The board shall prohibit the school district from self-certifying certain project information for any subsequent applications for project funding for a period of up to five years following the date of the finding of a Material Inaccuracy or until the district's repayment of the entire amount owed under paragraph (1)." The statute further states, "...The board shall establish an alternative method for state or independent certification of compliance that shall be applicable in these cases. The process shall include, but not be limited to, procedures for payment by the school district of any increased costs associated with the alternative certification process."

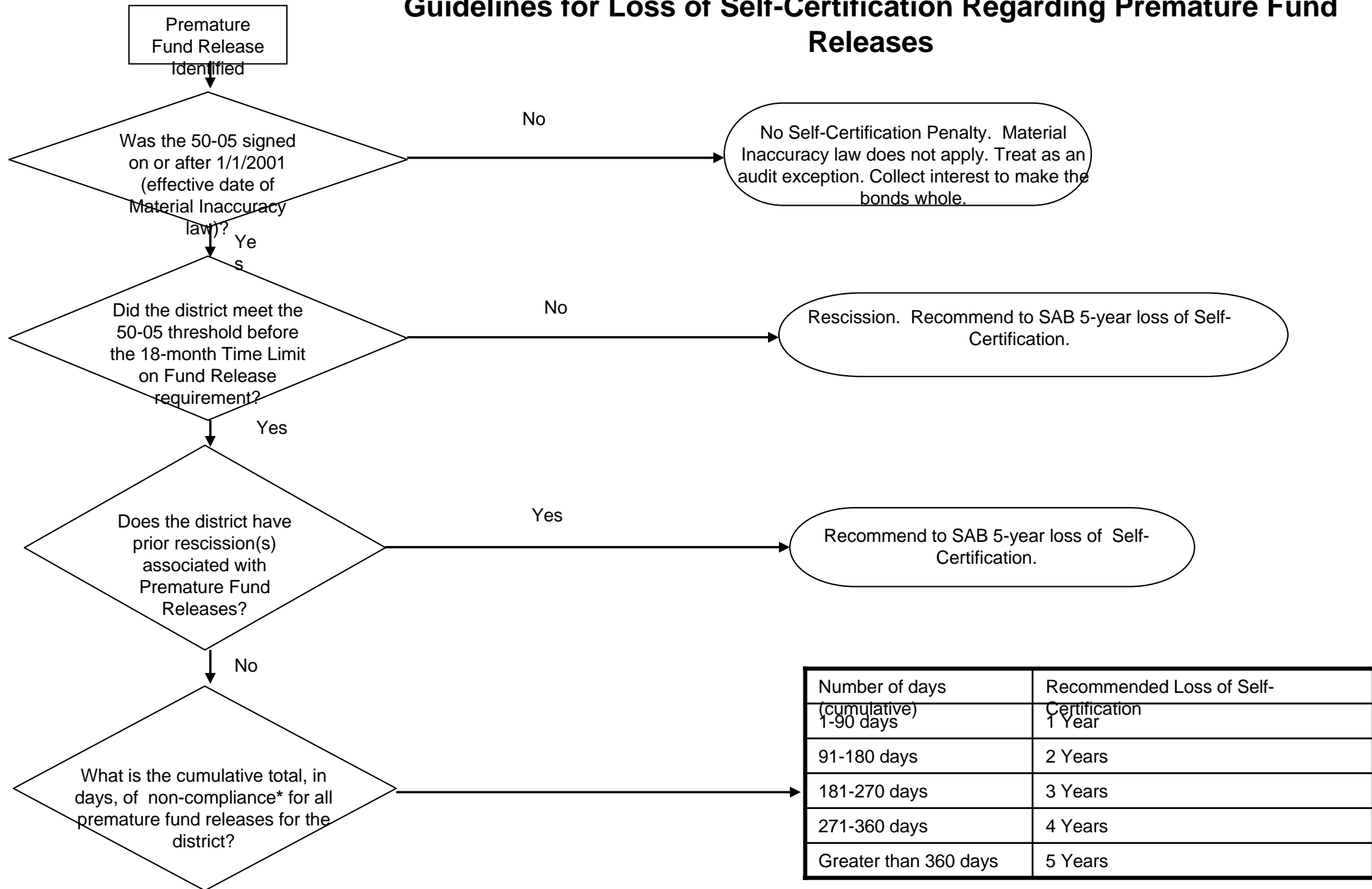
SFP Regulation Section 1859.104.1(c)(2) further clarifies EC Section 17070.51(b)(2) and requires that the district "shall be prohibited from self-certifying project information for a period of up to five years from the date the Board made the finding of Material Inaccuracy for the project. A prohibition from self-certification of project information may be less than five years as determined on a case-by-case basis by the Board."

SFP Regulation Section 1859.104.1(c)(3) states the district shall file all projects pursuant to Section 1859.104.2 for a period of up to five years from the date the Board made the finding of Material Inaccuracy for the project.

SFP Regulation Section 1859.104.1(c)(4) states the district shall be subject to the fee prescribed by Section 1859.104.3, which states if the SAB has made a finding of Material Inaccuracy, the SAB shall charge the district an amount of \$100 per hour for the additional hours to process and review the district's applications submitted during the timelines prescribed in Section 1859.104.1(c)(2).

ATTACHMENT B

Guidelines for Loss of Self-Certification Regarding Premature Fund Releases



*Non-compliance refers to the period from warrant release date to the date the district met the 50-05 threshold for past and current items.

ATTACHMENT C

PAST MATERIAL INACCURACIES

School District	Interest Penalty Assessed?	How was interest calculated?			Premature Fund Release?	SAB Approved Loss of Self-Certification	Reason for Material Inaccuracy		
		Period from the warrant release date to the date of the SAB approved rescission	Period from the warrant release date to the date the District agreed to the audit findings	Period from the warrant release date to the date the construction contracts/School Board Award Dates meets the <i>Fund Release Authorization</i>			Funding advantage through the false certification of <i>Enrollment Certification</i> (Form SAB 50-01).	Funding advantage through the false certification of <i>Fund Release Authorization</i> (Form SAB 50-05)	Funding advantage through the Non-disclosure of Certificates of Participation
A	Y		X		Y	5 years	X		
*B1	Y	X			Y	5 years		X	
*B2	Y			X	Y	5 years		X	
C1	Y			*X	Y	****5 years		X	
C2	Y			X	Y	**5 years		X	
D	Y			X	Y	1 year		X	
E	Y	X			N/A	5 years			X
F	Y			X	Y	*****TBD		X	
G	Y			X	Y	*****TBD		X	

Footnotes:

*District B, in the same SAB item, had both premature fund releases with rescissions (B1) and premature fund releases (B2).

**District C, in the same SAB item, had both premature fund releases with rescissions (C1) and premature fund releases (C2).

***The interest calculations for District C1 were calculated incorrectly. The interest should have been calculated from the warrant release date to the date of the SAB

****Period of loss of self-certification expired when the final repayment was made.

*****Districts F and G were presented at the January 2008 SAB Meeting. The length of the self-certification penalty will be determined at a future SAB meeting.